

New Program For Making Pre-Tax Voluntary Contributions to Your Annuity Savings Account

Dear Member:

Recently the Public Employees' Retirement Fund (PERF) and Indiana State Teachers' Retirement Fund (TRF) received approval from the Internal Revenue Service ("IRS") to permit some members to make additional voluntary contributions to their annuity savings accounts (ASAs) on a pre-tax basis. This gives members an additional option for enhancing their retirement savings through PERF and TRF. This letter briefly describes the new opportunity.

I. BACKGROUND

Until 2001, the contribution to PERF and TRF annuity savings accounts was set at a mandatory rate of three percent (3%) of your compensation.

Beginning in 2001, the Indiana General Assembly enacted a provision that allows PERF and TRF members to make voluntary contributions in addition to the mandatory three percent (3%) contributions. That change allowed you to increase your post-tax annuity savings account contributions up to an additional ten percent (10%) of your compensation per pay period. This means that the maximum level of contributions to your annuity savings account under this new provision is thirteen percent (13%) of your compensation per pay period.

As described below, beginning in 2003, eligible employees may choose to make these contributions on a pre-tax basis, subject to certain restrictions.

II. FREQUENTLY ASKED QUESTIONS

1.) What does the 2003 IRS ruling change?

The new IRS ruling adds the possibility of making additional ASA contributions with pre-tax dollars. This option will be available for qualifying members (see below for more details on how members will qualify to make these contributions.) Qualifying members must select whether to make their additional ASA contributions with post-tax dollars or pre-tax dollars. However, some very important limitations apply. For example, as a condition of the ruling an election to make pre-tax contributions may not be changed until the member retires or goes to work for a different employer. The IRS requires that the election be "irrevocable." See more details about the terms and conditions of the election below.

2.) Who is qualified to make pre-tax contributions?

Qualified members are those who are currently working for an employer that is participating in the pre-tax program, and who are within their two-year election period. An election period begins on September 1 after the fiscal year in which a member earns or is credited with five years of service. More information about the election period is described below.

3.) When is my election period to make a pre-tax election?

Under the terms of the IRS ruling, to receive a two-year election window, you must (i) have earned with five years of service in the prior fiscal year (ending June 30), and (ii) currently work for an employer who is participating in the pre-tax program. Your election window is the period of time when you will be able to elect to make pre-tax contributions. The two-year window starts on the September 1 following the fiscal year in which you earned five years of service.

Members who have changed jobs may also be entitled to have a two-year election window. As of June 30, PERF and TRF will determine who has completed or was reccredited with five years of service in the prior calendar year. Beginning on September 1, those members will receive a two-year election window. (See below for more information on being "reccredited" with five years of service after leaving PERF or TRF covered employment.)

Example 1: John participates in TRF and completed five years of TRF service in the month of March, 2005. Based on TRF's June 30, 2005 records, John earned five years of service credit in the fiscal year between July 1, 2004 and June 30, 2005. Therefore John is eligible to participate in the pre-tax voluntary contribution program and his two-year election period begins on September 1, 2005. (Note: the same timing rules apply to both PERF and TRF. If John were a PERF member, the same rule would apply).

Example 2: Alice participates in PERF and completed five years of PERF service in August, 2005. PERF determines who is eligible for the two-year election window that begins in September, 2005 based on its June 30, 2005 records. Because Alice did not have five years of service as of June 30, 2005, she is not eligible to make pre-tax contributions in September, 2005. However, as of June 30, 2006, PERF records show her as having earned five years of credit between July 1, 2005 and June 30, 2006. Therefore, her two-year election window begins on September 1, 2006. (Note: the same timing rules apply to both PERF and TRF. If Alice were a TRF member, the same rule would apply).

4.) Is there a special election period for when this program starts in 2003?

Yes. Anyone who has at least five years of creditable PERF or TRF service as of June 30, 2003, will be entitled to a two-year election period starting on September 1, 2003. For years thereafter, only members who complete their fifth year of service in a fiscal year ending June 30 will have a two-year election period on the following September 1.

5.) When can I make the pre-tax election?

You may make a pre-tax election at any time during your two-year election period.

6.) What happens if I do not participate during my two-year election period? Can I choose to participate at a later date?

You may only elect to participate in the pre-tax contribution program during your election period. If you do not elect to participate during the two-year election period that occurs

after you earn five years of service, you cannot later choose to participate unless you terminate employment and begin a PERF or TRF-covered job with a different employer.

7.) How do I make the pre-tax election?

You may make a pre-tax election by completing the election form during your election period. Important: Remember that you cannot change your pre-tax election. It is binding and irrevocable, see more details below.

8.) Can I make a post-tax election in addition to a pre-tax election?

Yes. You can make a post-tax election at the same time you make a pre-tax election, or at a later date, but the total of your voluntary pre-tax and post-tax contributions cannot exceed 10% of your compensation.

9.) How long will the pre-tax election apply?

YOUR PRE-TAX ELECTION CANNOT BE CHANGED. IT WILL CONTINUE TO APPLY AS LONG AS YOU WORK FOR THE SAME EMPLOYER, EVEN IF YOU LEAVE AND COME BACK TO WORK WITH THAT EMPLOYER.

10.) What if I leave and return to work?

If you leave work and return to the same employer, your pre-tax election form will remain in place. If you leave work and then take a job with a different employer, you are considered to be "recredited" with your years of service six months after you start a new job. Therefore, you will receive a new two-year election period based on when you were recredited with your years of service.

Example 3: Assume that John, described in Example 1, made a pre-tax election form during the two-year window that began after his fifth year of service. After working for a few years and making pre-tax contributions, he leaves TRF employment to work for a private company that does not participate in TRF. After working in the private sector for a few years, he returned to work in a TRF-covered position. If John returns to work for the same TRF employer that he worked for before leaving for the private sector, his pre-tax election will immediately apply to his salary when he resumes work.

If John returns to work in a TRF-covered position for a new TRF employer, he will receive a new two-year election period. After starting with the new employer, John is recredited with his prior service. The two-year election period is determined in the same manner as for someone who completes five years of service for the first time: as of June 30, PERF and TRF will determine who completed or was recredited with five years of service in the prior fiscal year. Beginning on September 1, those members will receive a two-year election window.

11.) If I make a pre-tax election, can my election be changed or stopped?

While you continue in employment, you cannot increase, decrease, or otherwise change your pre-tax contributions. You are not restricted from making after-tax contributions when you have elected to make pre-tax contributions, as long as the total of your contributions does not exceed 10% of your compensation.

12.) What is the taxable status of these contributions?

Additional voluntary contributions made through a pre-tax election are not taxable income to you at the time the contributions are made. Also, interest earnings on your annuity savings account, including interest earned from the voluntary contributions, will remain tax deferred until you receive payment via withdrawal or retirement.

If you make post-tax additional voluntary contributions instead of or in addition to pre-tax contributions, then those contributions are taxed to you when made. As with pre-tax contributions, interest earnings will remain tax deferred until you receive a refund of contributions or a retirement benefit. If you have any questions regarding the tax implications of the voluntary contributions, please consult a qualified tax advisor.

13.) How will the voluntary contributions be invested?

All voluntary contributions to the annuity savings account will be invested in the same manner and percentage as your annuity savings account monies are currently invested. You cannot separate the mandatory and voluntary contributions for investment purposes. For example, if you have all of your annuity savings account in the Guaranteed Fund, your voluntary contributions would be invested there as well. If you have a 50%-50% split between two investment options, that same split will apply to your voluntary contributions. The election you make will automatically apply to voluntary contributions. Specific rules apply to the investment of your annuity savings account. If you have questions about investments, please visit our home page on the World Wide Web at: <http://www.in.gov/trf> or contact us at our toll-free number at (888) 286-3544.

14.) How do I make voluntary contributions?

First, complete the attached form with all information requested. Once you have completed the attached form, please submit it directly to TRF. Once the form is received by the Fund, the Fund will verify your earned service and whether your employer has passed a resolution opting into the program. Once the Fund makes the verification, a copy of the form will go into the member's file and the original will be sent to the employer for processing. The Fund is not responsible for any delays in the collection of contributions resulting from the improper submission of this form.

The completion of the form means that you agree to have the amount you specified deducted from your take-home pay and sent to the Fund for investment.

15.) What if I want to change the percentage of my post-tax voluntary contributions?

If you decide to make voluntary contributions and later decide to change your percentage, you must complete another form and submit it to your payroll administrator or, if you are paid through the Auditor's Office, to the Auditor's Office. Your changes will become effective as soon as the payroll administrator or the Auditor's Office processes your request and sends it to TRF.

16.) Can I make additional pre-tax voluntary contributions if I am contributing the maximum amounts to my 403(b) and 457?

Yes. The additional pre-tax contributions (up to 10% of compensation) that you make under this program are not limited by the amounts you are contributing to your 403(b) or 457, or both. The contributions that are "picked up" under the pre-tax voluntary contribution program are not limited by section 415 of the Internal Revenue Code at the time the contributions are made to the plan; instead, they are subjected to the section 415 limits at the time you retire.

17.) What does my employer have to do before I may make an election?

Your employer must elect to participate in the pre-tax program by adopting a resolution with standard IRS-language. If your employer does not elect to participate by adopting this resolution, you may not make voluntary contributions on a pre-tax basis. You may check whether your employer has adopted the resolution by visiting <http://www.in.gov/trf>.

18.) Whom can I contact with questions about voluntary contributions to my annuity savings account?

Increasing your annuity savings account contributions could have a significant impact on your future retirement assets. You can contact your payroll administrator with any questions you have on the contribution. If you are paid through the Auditor's Office, you can contact the Auditor's Office with any questions you have on the voluntary contribution. If you have any questions about investment options or the effect of these contributions, you can contact TRF for further information at (317) 232-3860. You can also visit our website at: <http://www.state.in.us/trf>.